

VZCZCXRO6724
RR RUEHLH RUEHPW
DE RUEHIL #3403/01 3021415
ZNR UUUUU ZZH
R 281415Z OCT 08
FM AMEMBASSY ISLAMABAD
TO RUEHC/SECSTATE WASHDC 9517
INFO RUEATRS/DEPT OF TREASURY WASHINGTON DC
RUCPDO/DEPT OF COMMERCE WASHINGTON DC
RUEHML/AMEMBASSY MANILA 3057
RUEHBUL/AMEMBASSY KABUL 9319
RUEHNE/AMEMBASSY NEW DELHI 3952
RUEHLO/AMEMBASSY LONDON 8972
RUEHKP/AMCONSUL KARACHI 0529
RUEHLH/AMCONSUL LAHORE 6265
RUEHPW/AMCONSUL PESHAWAR 5101
RUMICEA/USCENTCOM INTEL CEN MACDILL AFB FL
RHMFISS/CDR USCENTCOM MACDILL AFB FL
RUEAIIA/CIA WASHDC
RUEKJCS/SECDEF WASHINGTON DC

UNCLAS SECTION 01 OF 02 ISLAMABAD 003403

SENSITIVE
SIPDIS

E.O. 12958: N/A

TAGS: [ECON](#) [EFIN](#) [ETRD](#) [PREL](#) [PGOV](#) [PK](#)

SUBJECT: PAKISTAN'S INACTION MAKES DEFAULT MORE PROBABLE

11. (SBU) Summary. Over the past ten days foreign exchange reserves dropped 13 percent to USD 3.52 billion on October 27. Fuel subsidies have been quietly phased out but electricity subsidies are on pace to exceed the budgeted funds for FY 2008-09. Credit-default swaps (CDS) spreads on Pakistan's USD 2.7 billion of dollar-denominated bonds outstanding have jumped making Pakistan one of the riskiest debts in the world. Moody's downgraded Pakistan's sovereign debt rating and may downgrade further based upon the timeliness, adequacy, and prospects for sustainability of an IMF program. End Summary.

FOREIGN RESERVES DWINDLING

12. (SBU) Foreign reserves of Pakistan's Central Bank are down to USD 3.52 billion (equivalent to 29 days of imports based on Post calculations) as of October 27, from USD 4.03 billion just ten days ago.

RISKIEST DEBT IN THE WORLD

13. (SBU) Credit-default swaps (CDS) on Pakistan's USD 2.7 billion of dollar-denominated bonds outstanding have jumped to 5,106 basis points according to CMA Datavision, an increase of 1,620 basis points from yesterday. It now costs USD 5.1 million annually to protect USD 10 million of the country's debt from default for five years.

ENERGY SUBSIDIES

14. (SBU) While not announced publicly, the Government of Pakistan (GOP) has eliminated all fuel subsidies as of October 16, due to the drop in international pricing. Current retail prices are as follows: Petrol Rs. 81.68 (USD 1.00 at 81.35 rupees per dollar); Light Diesel oil: Rs 60.00 (USD 0.74); Kerosene: Rs 61.87 (USD 0.76); High Speed Diesel Rs 68.14 (USD 0.84). The GOP has kept the prices of diesel and petroleum unchanged since September 15, despite drastic falls in the international crude oil prices. On October 28, the Ministry of Petroleum proposed a reduction of Rs 5 (USD 0.06) per liter for both diesel and petroleum to the Ministry of Finance. Petroleum product prices are due to come under official review by the Cabinet at the end of this month. Pakistan's Oil and Gas Regulatory Authority (OGRA), calculates and reviews prices of

petroleum products each fortnight. The current retail prices for petroleum allow the GOP to overcharge consumers by about Rs 30 per liter (USD 0.37). For FY 2008-09 the GOP had budgeted Rs 140 billion (USD 1.72 billion) for fuel subsidies.

15. (SBU) Due to the recent decision to suspend a tariff increase on electricity, the GOP has assumed a greater portion of electric subsidies than planned in the FY 2008-09 budget. While the GOP had planned Rs. 65 billion (USD 799 million) to be paid in electricity subsidies, they have already spent Rs 26.250 billion (USD 322 million) in the first fifteen weeks of the fiscal year according to Ministry of Petroleum Section Officer Waqar Asgar Rana. The GOP has also budgeted Rs 1.7 billion (USD 20.9 million) in subsidies for natural gas in FY 2008-09 according to Alltaf Hussain Deputy Executive Director for Finance at the Oil and Gas Regulatory Authority.

DOWNGRADED AND OUTLOOK GRIM

16. (SBU) Moody's Investor Service downgraded Pakistan's sovereign bond rating from B2 to B3. A ratings downgrade would typically raise the cost of new borrowing but Yousef Ahmad, Director for Citibank in Pakistan noted that commercial credit is functionally unavailable to Pakistan and its existing sovereign securities are currently traded at a discount of 60 to 65 percent. In the public statement Moody's analyst for Pakistan, Aninda Mitra, explained that the "rating action was prompted by the continuing erosion of the country's external liquidity position, which has remained inadequately addressed by policy adjustments and has suffered from

ISLAMABAD 00003403 002 OF 002

delays in assistance from key bilateral and multilateral creditors." Pakistan has a USD 500 million global bond obligation due in February 2009 which market participants consider its greatest near-term test.

17. (SBU) Moody's continues to keep Pakistan on review for further downgrade due to uncertainty about the size, timeliness and durability of an IMF program, an option the Government of Pakistan continues to describe as a last resort. "Even if an IMF assistance package were to avert a near-term default, Pakistan's intrinsic ability to generate greater access to foreign exchange has dimmed," says Mitra. He adds that "Insufficient macro-economic adjustments, weak prospects for structural reforms, and a chronic shortage of foreign exchange were likely to heighten Pakistan's need for medium-term balance-of-payments support, or raise the risk of a hard economic landing."

PATTERSON